STATE OF CALIFORNIA
ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION

In the Matter of:	
Informational Proceeding and Preparation of the 2007 Integrated Energy Policy Report	Docket No. 06-IEP-1
Implementation of Renewables Portfolio Standard Legislation (Public Utilities Code Sections 381, 383.5, 399.11 through 399.15, and 445; [SB 1038], [SB 1078])	Docket No. 03-RPS-1078 RPS Proceeding
	Notice of Committee Workshop

Comments of the Alliance for Retail Energy Markets on RPS Issues for 2006 Integrated Energy Policy Report Update – RPS Mid-Course Review

Background

The Alliance for Retail Energy Markets (AReM)[1] strongly supports the efforts of the California Energy Commission (CEC) to "simplify and streamline" the California RPS and respectfully submits the following comments in support of the 2006 Integrated Energy Policy Report Update - RPS Mid-course Review. Specifically, the comments below are in response to the topics explored during the August 22, 2006, Committee Workshop on the Mid-Course Review of the Renewables Portfolio Standard Process.

AReM members are committed to complying with the RPS in California and have been active participants in the process to develop an effective and workable RPS compliance program. ESPs intend to participate and comply with rules established by the California Public Utilities Commission (CPUC) and the CEC. It is AReM's goal to seek

[1] AReM is a California mutual benefit corporation whose members are electric service providers that are active in California's direct access market. The positions taken in this filing represent the views of AReM but not necessarily those of any individual member of AReM or the affiliates of its members with respect to the issues addressed herein.

clear and simple rules for compliance that help achieve the policy goals of the state while recognizing the unique aspects of the role that ESPs play within the electric industry in California.

The August 22 workshop focused on two issues, supplemental energy payments (SEPs) and transmission. While AReM acknowledges that transmission is a serious issue for renewable energy and supports the CEC's exploration of solutions to this statewide challenge, AReM will confine its remarks here to the issue of SEPs.

I. Fundamental questions about the continuing viability of the SEPs mechanism need to be addressed.

AReM recognizes the CEC's ability to change the SEPs mechanism is constrained by statute. However, the CEC is a thought leader in California on these matters and is taking the initiative to examine the RPS for possible mid-course corrections. This examination should be welcomed by any Californian that is interested in the success of renewable energy in our state. AReM strongly supports this review and appreciates the opportunity to provide you with AReM's thoughts on these matters.

Rather than analyzing minor details of the complex calculations that go into creating the Market Price Referent (MPR), the CEC should be asking itself whether the entire SEPs/MPR mechanism makes sense at all. After all, several serious problems with the current mechanism were acknowledged at the workshop.

Before we discuss the specific problems with the SEPs mechanism, it is important to remember why the SEPs/MPR mechanism was developed in the first place. The RPS was created to increase the amount of electricity generated from renewable energy in California, while the basic function of SEPs is "to cover the above market costs of renewable resources as approved by the Public Utilities Commission and selected by retail sellers to fulfill their [RPS] obligations. . ." [2]

So, there are two competing public policy goals embedded in the legislation that created both the RPS requirement and the SEPs mechanism. One goal is to increase the amount of renewable generation for the state; the other goal is to insulate customers from the above market costs of that increased renewable generation. The irony of this

[2] Pub. Res. Code § 25743(b)(1).

mechanism is that the funding source for the SEPs, the Public Goods Charge (PGC), comes from customers' utility bills, so that in reality, the SEPs mechanism is taking money from one customer pocket and using that funding to "shield" consumers from additional costs coming from another pocket. In practice, there are a number of flaws in the system as it is currently structured which are only going to become more apparent over time as the Western states move to a regional registry of renewable generation. We describe some of the key flaws in the SEPs mechanisms below.

A. *Customers are currently paying the PGC but renewable generators are not receiving financial incentives for additional generation.*

To date, virtually no generators have applied for SEPs. On the one hand this is a good thing since it means that prices of renewable generation tendered under the utility Request for Proposal (RFP) processes have been very competitive with generic power. However, customers are still paying the PGC. Therefore, the SEPs mechanism is not serving either of the dual policy goals—encouraging renewables while insulating customers from the costs. Of course, this situation may change in the future as more expensive renewable resources are required. However, at present, the SEPs mechanism appears to have little to no impact on new renewable generation decisions.

B. *SEPs provide insufficient certainty for generators to obtain long-term project financing.*

This issue was mentioned in the August 22 workshop by a number of parties, including Commissioner Geesman. The general consensus seemed to be that an award of SEPs would not be considered secure enough to obtain financial backing. AReM does not have any additional evidence to add on this topic. However, if this is true, as most parties appear to agree, then it is a very strong indictment of the entire SEPs mechanism since SEPs would not be supporting the first public policy goal of increasing renewable generation.

C. *The SEPs/MPR mechanism is unnecessarily and seriously complex.*

Any attendee of the August 22 workshop, who listened to the explanation of the derivation and function of Time-of-Day factors or listened to the discussion of the different gas forecasts used to calculate the MPR, must conclude that this SEPs/MPR methodology is overly complex and far from transparent! However, exploring alternatives to the SEPs/MPR mechanism presents a great opportunity for California to simplify its RPS.

D. *SEPs are not easily applied to ESPs or Community Choice Aggregators (CCAs).*

As the compliance process for ESPs and CCAs is being developed, it has become evident that the SEPs mechanism does not readily apply to entities whose procurement is not regulated by the CPUC. The SEPs mechanism was designed to be used in the context of a regulated utility regime and is inflexible for use by non-regulated entities. ESPs currently serve approximately 11% percent of the California customer load in the Investor Owned Utility (IOU) territories. The direct access customers of the ESPs pay the PGC, the same as bundled customers, as will Community Choice Aggregation (CCA) customers should CCAs eventually be established in California.

The process for obtaining SEPs starts with the IOUs having a RPS procurement plan approved by the CPUC. The IOUs subsequently conduct solicitations for eligible renewable resources. The IOUs have to then demonstrate that the "winners" of that solicitation meet "least-cost, best fit" criteria. The CPUC is responsible for accepting or rejecting the winners and can direct the IOUs to re-negotiate if it does not agree the terms are reasonable. An MPR is calculated and approved contracts that meet or exceed ten years in length, and exceed the MPR price, can then request SEPs from the CEC.

This process does not adapt very well to ESPs and CCAs. The CPUC does not regulate the general procurement practices of either ESPs or CCAs for generic or renewable power. Nor can the CPUC guarantee price recovery for the ESPs and CCAs since it does not set rates for them. ESPs and CCAs are also more likely to rely on shorter term contracts because they do not have a guaranteed customer base and are on average much smaller than the utilities. Certainly, the process could be adapted to fit

with ESPs and CCAs, but it would be difficult. A recent Proposed Decision on various RPS matters at the CPUC captured the problem well:

> "No analogous process is currently in place for RPS procurement contracts of ESPs or CCAs. Constructing one would require concentrated effort from parties and our staff."[3]

AReM requests that the CEC formally recognize the principle that direct access customers pay into the SEP account at the same levels as the IOUs' bundled customers. Accordingly, the price protection for RPS compliance afforded by SEPs should apply equally for direct access customers and bundled service customers. Currently, it does not.

E. ***The SEPs process would need to be modified to accept contract terms shorter than 10 years and to accommodate bi-lateral contracts.***

Currently, SEPs are not available for contracts shorter than 10 years or for contracts that were entered into bilaterally, i.e. not through a competitive RFP process. This is true for IOUs, ESPs, and CCAs alike. There is nothing inherently inferior about the electricity generated from a wind farm under a 5 year contract negotiated bilaterally, as compared to the electricity generated from another wind farm under a 10 year contract won through an RFP process. While it is likely the majority of the new renewable generation needed in California to meet the RPS will be under long-term contracts, flexibility is limited by a SEPs mechanism that discriminates against the renewable generator who, for whatever reason, does not want a long-term contract or prefers to negotiate bilaterally instead of participate in an RFP. Those restrictions seem to cut against both public policy goals of wanting more renewable energy and protecting ratepayers from above market costs by removing options from both the buyer and seller to strike their best deal. The SEPs mechanism should be modified to accept shorter term contracts and bilateral contracts.

[3] Proposed Decision of ALJ Simon in R. 06-02-012, August 22, 2006, p. 36.

F. *The SEPs/MPR Mechanism is Not Easily Adapted to the Use of Renewable Energy Credits (RECs).*

The CEC is required by statute to "establish a system for tracking and verifying renewable energy credits."[4] The CEC recently approved a contract for APX to develop the software for this system. It is highly likely that once this WREGIS system is up and running that RECs will become the way to verify compliance with the RPS. Already 16 other states in the country with RPS laws allow or require the use of RECs for RPS compliance. REC-based compliance is the dominant structure for the measurement and verification of RPS claims across the country.

However, the SEPs/MPR mechanism is not easily adapted to the use of RECs because it was designed narrowly to deal with bundled purchases of electricity. In some sense, the price of RECs becomes the above market price of renewable energy but, when separated from the underlying power, whose price is unknown to WREGIS and the REC buyer, it is difficult to tell what the total bundled price of RECs plus power would have been.

It may take a couple of years but eventually RECs will be the method of determining compliance with California's RPS and at that time the SEPs/MPR process will be obsolete. The CEC should begin considering alternatives now in advance of that time, particularly given the other problems that with the SEPs/MPR mechanism discussed above.

II. Given the Problems with the Current SEPs/MPR Mechanism, the CEC Should at Least Consider Other Options.

AReM is not recommending a particular alternative to the SEPs/MPR mechanism at this time. However, we would like to point out that there are several other options and that while the CEC is considering Mid-Course Corrections, it should consider these and other potential replacements to the SEPs/MPR mechanism.

[4] Public Utilities Code Section 399.13 (c)

A. *Option A: No Financial Incentive Program*

The RPS by itself is an incentive program in that it requires the purchase of a certain amount of power from a certain source — renewable energy. California could abolish the SEPs MPR mechanism and simply say that all load serving entities (LSEs) have to meet the RPS. This would save customers money by significantly reducing the PGC. However, these savings might be offset by the additional cost of renewable power that would be factored into the LSE's rates.

B. *Option B: Alternative Compliance Payments*

Six states with RPS policies currently employ Alternative Compliance Payments (ACPs) as a cost mitigation measure. Under this approach, LSEs can pay an ACP in lieu of purchasing a REC when the cost of a compliance REC exceeds a pre-specified level (e.g. $50/MWh),. In most cases, the ACPs are paid into a fund which is used to support new renewable generation. This still puts the cost of RPS into the rates of the LSE but effectively puts an upper limit on the amount they would have to pay for wholesale renewable power.

C. *Option C: Reverse-Auction for Renewable Above-Market Payments.*

The CEC previously administered a successful program under the New Renewables Account Program. Under this system, any above-market price payments are made to generators based on a competitively-bid reverse auction process, where the generators requiring the lowest project subsidies are first in line to receive payments. This system decouples above-market costs from the underlying energy and REC products and helps to ensure that the most cost-competitive projects are built. This system worked well for several years at the CEC and resulted in payments for approximately 1,300 MW of new renewable generation.[5] With no need to calculate an MPR, the reverse auction puts downward pressure on subsidy payments, and the CEC has already had experience implementing this option successfully.

[5] http://www.energy.ca.gov/renewables/new_renewables/index.html (August 25, 2006)

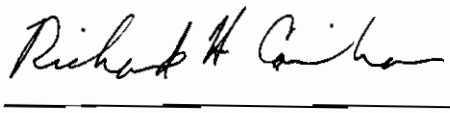
D. *Option D: Feed-In Tariffs*

During the workshop, there was a presentation regarding the European Feed-In Tariffs and the subsequent discussion of the pros and cons of these tariffs. AReM will not reiterate that discussion here, but observes it should take place in a larger context of whether SEPs should continue and, if not, what should replace them.

III. Conclusion

In conclusion, AReM believes that the CEC and the CPUC should be considering whether the cumbersome SEPs/MPR process should continue and, if not, what is the best way to meet the two public policy goals of the RPS legislation—to increase the amount of electricity from renewable generation sources while at the same time protecting customers from potential price increases. AReM recognizes that legislation would be required to make changes to the current system but recommends that the Commissions jointly begin the discussion.

Respectfully submitted,



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On behalf of the
ALLIANCE FOR RETAIL ENERGY MARKETS

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